R5650-2

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 25B
June 29, 1990

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Japan's GNP Jumps In First Quarter

Chicken Little could have had a field day in Japan three months ago. The plummeting stock market suggested to some analysts that the Japanese economy was in deep trouble. But, as the fabled bird discovered, appearances can be deceiving. The Economic Planning Agency's recent release of the gross national product figures for the January-March period was the latest indication that the Japanese economy avoided serious short-run harm. Even though the stock market dropped substantially in the first three months of 1990, Japan's price-adjusted gross national product surged 2.5 percent over the October-December quarter -- a jump that translates to 10.4 percent growth on an annualized basis (see Table).

The latest GNP report was not without its surprises, however. Since the yen's appreciation between 1985 and 1988, rising domestic demand typically has offset declining net foreign demand by enough to yield positive overall quarterly GNP growth rates. In the January-March period the pattern was strikingly

Japan's Real Gross National Product at Constant (1980) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1988	FY 1989	April-June 1989	July-September 1989	October-December 1989	January-March 1990
Gross National Product	Y334,968.8 (5.3%)	Y351,876.5 (5.0%)	Y340,561.8 (-3.0%)	Y350,436.1 (12.1%)	Y353,352.3 (3.4%)	Y362,202.3 (10.4%)
Personal Consumption Spending	185,317.8 (5.0%)	191,232.8 (3.2%)	186,600.8 (-3.9%)	190,316.4 (8.2%)	193,336.8 (6.5%)	194,396.8 (2.2%)
Private Residential Construction	20,686.8 (5.3%)	21,502.5 (3.9%)	20,855.0 (-8.8%)	21,328.5 (9.4%)	21,744.6 (8.0%)	22,190.1 (8.5%)
Private Fixed Nonresidential Investment	72,617.1 (17.3%)	84,584.1 (16.5%)	78,320.0 (2.6%)	83,374.1 (28.4%)	86,710.4 (17.0%)	89,067.7 (11.3%)
Change in Business Inventories	2,080.6 (*)	1,844.3 (*)	2,463.2 (*)	2,077.4 (*)	2,117.2 (*)	777.7 (*)
Government Current Expenditures	29,341.5 (2.2%)	29,909.1 (1.9%)	29,650.4 (0.0%)	29,732.0 (1.0%)	30,013.5 (3.8%)	30,236.0 (3.0%)
Government Fixed Investment	24,621.6 (1.2%)	24,543.6 (-0.3%)	24,540.4 (-2.2%)	24,205.1 (-5.4%)	24,509.2 (5.1%)	24,843.3 (5.6%)
Change in Government Inventories	-185.0 (*)	-35.9 (*)	371.8 (*)	63.4 (*)	-949.1 (*)	357.9 (*)
Net External Sector	488.4 (-33.7%)	-1,704.0 (-448.9%)	-2,239.8 (235.3%)	-660.8 (*)	-4,130.3 (*)	332.8 (*)
Exports of Goods and Services and Factor Income Received	61,457.7 (10.7%)	71,018.3 (15.6%)	65,824.7 (-3.2%)	70,171.1 (29.1%)	71,054.2 (5.1%)	77,114.1 (38.7%)
Imports of Goods and Services and Factor Income Paid	60,969.3 (21.4%)	72,722.3 (19.3%)	68,064.5 (10.0%)	70,831.9 (17.3%)	75,184.5 (26.9%)	76,781.3 (8.8%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

different. Net exports accounted for 1.3 percentage points of the overall quarterly growth rate; without the slight offsetting effect of rising imports, the external sector would have contributed 1.7 points to the expansion.

In contrast, domestic demand -- while up -- was anemic, both in comparison to previous quarters and to net exports. Consumer spending, for example, rose only 0.5 percent from the previous quarter and accounted for a measly 12 percent (0.3 point) of overall growth despite making up more than half the total economy. Private plant and equipment spending rose 2.7 percent and chipped in 0.7 point of overall growth, an excellent performance by most standards but sharply lower than in the previous two quarters for this recent perennial champion.

Why the distinctly different pattern in the January-March quarter? An analyst attempting to find fault with Japanese economic policy might explain that once the domestic economy got into trouble, as reflected in the stock market's turbulence, Japanese companies solved their problems the old-fashioned way: they exported. If this analyst were sufficiently cynical, he or she might add that this turnabout explains the emergence in some quarters of Japan of a "surpluses are good for Japan and the world" argument concerning the size of Japan's global imbalance (see article in this issue).

Such an explanation would be seriously misleading. The rise in exports and the stock market turmoil <u>are</u> related but not in the way the above rationale assumes. Tighter monetary policy and the accompanying increases in interest rates during the first quarter were partly a response to the yen's prolonged softness as well as a contributing factor to the weakness in the stock market. The rise in exports was rooted in the weaker yen; it also reflected adjustments typical of the close of a fiscal year. Higher interest rates also may have been behind the sluggish state of domestic demand, including the slower expansion of plant and equipment investment. In addition, the decline in the stock market may have had a further adverse effect on capital spending. This argument suggests that the first-quarter GNP data essentially are a blurred picture of an economy in transition to higher interest rates and, possibly, a stronger yen. It does not suggest a linkage between weak domestic demand and export growth. Nor does it have unambiguous implications for the direction of the current account surplus.

Data for the fiscal year that ended March 31, released simultaneously with the quarterly figures, present a far clearer snapshot of the mid-1990 Japanese economy. GNP expanded 5 percent in real terms in FY 1989, far above the government's initial outlook of 4 percent growth and even higher than its late 1989 estimate of 4.6 percent. Domestic demand accounted for 5.7 points of the expansion, of which the private sector contributed 5.5 points. By contrast, net exports shaved 0.7 point off the growth rate. For the fiscal year the current account represented 1.9 percent of nominal GNP, down from 2.7 percent in FY 1989 and the peak of 4.5 percent registered in FY 1986. In other words, the current account declined by more than 50 percent relative to GNP between FY 1986 and FY 1989.

Most analysts believe that FY 1990 will not look that different from FY 1989. Some experts have trimmed their expected growth rates from those made in late 1989 and early this year. (For details of the earlier forecasts, see JEI Report No. 8A, February 23, 1990.) Industrial Bank of Japan, Ltd., for example,

expected 4.6 percent real growth for FY 1990 as of February; a May forecast reduced that to 4.2 percent, still above the government's expectation of 4 percent growth. IBJ anticipates that the current account surplus will decline to $42.4 billion from $53.5 billion in FY 1989. If the bank's projections are accurate, the current account will continue to decline as a percentage of GNP. In short, the Bank of Japan's tighter monetary policy will be felt, but few catastrophic changes -- either from an American or a Japanese perspective -- are likely during the current fiscal year.

Douglas Ostrom

MOF Retreats On Current Account Surplus Debate

Criticism from other ministries as well as from overseas has dampened the Ministry of Finance's ardor toward a benign interpretation of a sizable Japanese current account surplus. An International Monetary Fund report issued in May gave weight to a perception that Japan needs to maintain a fairly substantial current account surplus to finance the new reconstruction needs of Eastern Europe as well as continue its role as a source of capital to developing and developed countries (see JEI Report No. 23B, June 15, 1990). Worried that this revisionist viewpoint would lead Tokyo to deemphasize structural economic reforms and import promotion policies, Bush administration officials harshly attacked its logic. In turn, concerned that the foreign backlash would reignite trade frictions, the Ministry of Foreign Affairs and the Ministry of International Trade and Industry downplayed the debate. Although the Finance Ministry is backing away from the new interpretation, data hinting that Japan's current account surplus may begin to widen will test Tokyo's mettle.

The International Monetary Fund, arguably the originator of the debate, since has stressed that its policy recommendation never was meant to justify the persistence of a big Japanese current account surplus. The IMF argued against reducing the surplus too rapidly, which might cause adjustment problems for the global economy, and against cutting the surplus by implementing measures that trim national savings. (In fact, the report prescribes savings-promotion policies to meet the needs of the world's capital-starved countries and to cure the macroeconomic imbalances of Japan, the United States and West Germany.) The report does not say, however, that Japan should try to perpetuate its large current account surplus.

Signaling a change of heart, Makoto Utsumi, vice finance minister for international affairs, reiterated June 21 that reducing the country's current account surplus remains a keystone of Japanese economic policy. He blamed the squabble on inflammatory newspaper reporting. An official change in policy never was considered, according to Mr. Utsumi. He added that advocates of the benign interpretation confused the necessity of promoting savings with the desirability of a current account surplus. Japan, he said, can reduce its current account surplus as well as export capital to the world. This position is supported by 1989 balance-of-payments figures showing not only that the long-term capital outflow is greater than the current account surplus but that the outflow increased while the surplus was falling.

A number of factors, however, point to the possibility that Japan's current account surplus will begin to widen in the near future. Government and